

GAO

United States General Accounting Office

Report to the Secretary of Defense

July 1998

MILITARY HOUSING

Privatization Off to a
Slow Start and
Continued
Management Attention
Needed



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GAO

United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-279995

July 17, 1998

The Honorable William S. Cohen
The Secretary of Defense

Dear Mr. Secretary:

This report discusses the Department of Defense's (DOD) new military housing program known as the Military Housing Privatization Initiative. Specifically, we reviewed the implementation of the new initiative to (1) measure progress to date, (2) assess issues associated with privatizing military housing, and (3) determine whether the new initiative is being integrated with other elements of DOD's housing program.

This report contains recommendations to you. As you know, as the head of a federal agency, you are required under 31 U.S.C. 720 to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Reform and Oversight no later than 60 days after the date of this report. A written statement must also be submitted to the Senate and House Committee on Appropriations with an agency's first request for appropriations made more than 60 days after the date of this report.

We are sending copies of this report to appropriate congressional committees; the Secretaries of the Army, the Navy, and the Air Force; the Commandant, U.S. Marine Corps; and the Director, Office of Management and Budget.

If you or your staff have questions on this report, please call me on (202) 512-5140. Major contributors to this report are listed in appendix VII.

Sincerely yours,



Mark E. Gebicke
Director, Military Operations
and Capabilities Issues

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Executive Summary

Purpose

The Department of Defense (DOD) spends about \$8 billion annually to provide housing for military members and their families either by paying cash allowances for members to live in private sector housing or by assigning members to military-owned or -leased quarters. Over the past several years, DOD has expressed concern over the poor quality of the military housing inventory and the need for renovations and improvements to bring the housing up to contemporary standards. To improve housing faster and more economically than could be achieved if only traditional military construction appropriations were used, the Congress approved DOD's request for a new initiative, known as the Military Housing Privatization Initiative, that allows and encourages private sector financing, ownership, operation, and maintenance of military housing. Under the initiative, DOD can provide direct loans, loan guarantees, and other incentives to encourage private developers to construct and operate housing either on or off military installations.

Because it represents a new approach to improving military housing, GAO reviewed the implementation of the new initiative to (1) measure progress to date, (2) assess issues associated with privatizing military housing, and (3) determine whether the new initiative is being integrated with other elements of DOD's housing program.

Background

DOD officials testified before the Congress in March 1998 that about 200,000 of the existing military-owned family housing units were old, had not been adequately maintained and modernized, and needed to be renovated or replaced. Although GAO's work performed in 1996 questioned DOD's methodology for estimating military housing requirements, it is clear that DOD faces a significant challenge in this area.¹ Using traditional military construction financing at current funding levels, DOD has estimated that over \$20 billion and 30 to 40 years would be required to upgrade or replace existing family housing. In addition, DOD estimated that most of the services' 400,000 unaccompanied barracks spaces also were old and needed major improvements estimated to cost about \$9 billion using traditional funding methods.

DOD concluded that these problems could be solved faster and more economically if the military could take advantage of the private sector's investment capital and housing construction expertise. The basic premise was to encourage private sector investment, rather than use government

¹Military Family Housing: Opportunities Exist to Reduce Costs and Mitigate Inequities (GAO/NSIAD-96-203, Sept. 13, 1996).

funding, to build and operate housing on military installations or in nearby communities where local markets could not meet military housing needs.² As tenants in the privatized housing, military occupants would receive a housing allowance and pay rent. DOD's goal was to reduce the government's near-term outlays for housing revitalization by encouraging the private sector to invest at least \$3 in military housing development for each dollar that the government invested.

At DOD's request, the Congress enacted a series of legislative authorities, termed the Military Housing Privatization Initiative, in fiscal year 1996 to test over a 5-year period use of various incentives and arrangements to encourage private sector investment in military housing. Among other things, these authorities permit DOD to (1) provide direct loans and loan guarantees to private entities to construct or revitalize housing, (2) convey or lease existing property and facilities to private entities, and (3) allow developers to build military housing using room patterns and floor areas comparable to similar housing in the local communities. With the new authorities, DOD stated that its housing problem could be solved with current funding levels in 10 years.

Separate DOD offices have key responsibilities for the military's housing program. Responsibility for the new privatization initiative and for other matters involving the construction, operation, and maintenance of military housing lies with the Under Secretary of Defense for Acquisition and Technology. Appropriations for military-owned and -leased family housing are included in the services' military construction and family housing accounts. Responsibility for housing allowances and for all compensation issues lies with the Under Secretary of Defense for Personnel and Readiness. Appropriations for housing allowances are included in the services' military personnel accounts.

Results in Brief

DOD considers privatization to be a powerful new tool to help address the military housing problem. However, implementation of the initiative is off to a slow start. Two years have passed since the new authorities were signed into law, yet no new agreements have been finalized to build or renovate military housing. More than a dozen projects are being considered; however, only one project is close to contract signing.

²DOD Policy Manual 4165.63M states that private sector housing in the communities near military installations will be relied on as the primary source of family housing. The policy states that government housing may be programmed when the local communities cannot meet the military's need for acceptable and affordable housing. DOD studies show that the cost to the government is significantly less when military families are paid an allowance and live in housing in the local communities.

According to DOD, progress has been slower than expected because the initiative represents a new way of doing business for both the military and the private sector. Many legal, financial, contractual, and budgetary scoring issues had to be resolved to the satisfaction of parties representing the government, developers, and private lenders. Although DOD expects implementation to speed up after the first few privatization deals are completed, it is difficult to predict how much the program can be accelerated given the unique circumstances of individual projects. In 1997, DOD changed its initial 10-year goal for solving the military's housing problem by fiscal year 2006 by extending the goal 4 years, to fiscal year 2010.

In addition to potential benefits, implementation of the privatization initiative raises several concerns. One concern is whether privatization will result in significant cost savings. To a large degree, privatization shifts funding from military housing construction, operations, and maintenance accounts to military personnel accounts to pay for increased housing allowances used to pay rent to developers of privatized housing. GAO's review of the services' life-cycle cost analyses for two privatization projects disclosed that the difference in the cost of privatization and traditional military construction financing was considerably less than the services' estimates and relatively modest—about 10 percent or less. Another concern is that the long term—50 years—proposed for many privatization projects may increase the potential that the housing may not be needed in the future, the contractor might not operate and maintain the housing as expected, and civilians might occupy on-base housing if it is not fully used by military members.

The privatization initiative has not been fully integrated with other elements of an overall housing strategy to meet DOD's housing needs in an optimum manner. First, the services have not corrected long-standing weaknesses in their requirements determination processes and therefore are not assured that they are constructing, replacing, or revitalizing housing only at installations where the local communities cannot meet the housing needs of military families. Second, although DOD's policy is to reduce costs by maximizing the use of housing in local communities, DOD has not taken full advantage of this policy. More accurate processes for determining housing requirements, for example, would show that the communities surrounding many installations can meet thousands of additional family housing requirements. Comprehensive housing referral services could also lessen the need for government housing, yet only the Navy has aggressively pursued this option. Finally, better coordination

between the separate offices responsible for housing allowances and military housing construction and management could ensure that their decisions on housing matters are made in concert, rather than in isolation, with each other. Comprehensive, better integrated plans could tie together the elements of DOD's housing program and help maximize the advantages of the privatization initiative while minimizing total housing costs.

Principal Findings

Privatization Is Off to a Slow Start

Although initial goals were aggressive and DOD actively pursued implementation of the new initiative, actual progress has been slow. In July 1997, DOD revised its target for solving its housing problem in 10 years when it directed the services to plan to revitalize, divest through privatization, or demolish inadequate family housing by fiscal year 2010, 4 years later than the original target. According to DOD, progress has been slower than expected because the initiative represents a new way of doing business; and as a result, many management, legal, financial, contractual, and budgetary scoring issues had to be addressed and resolved.

The timeline for a planned privatization project at Fort Carson, Colorado, illustrates the slow progress in implementing an agreement under the initiative. In October 1993, prior to the start of the initiative, the Army requested and the Congress appropriated \$16.5 million in military construction funds to replace 142 family housing units at Fort Carson in fiscal year 1995. The project was approved, but construction did not begin and the funds were held in abeyance as the Army considered how privatization might be used to finance a much larger housing project. A DOD evaluation team visited Fort Carson in December 1995, and in June 1996, DOD concluded that Fort Carson was a good privatization candidate. A request for proposal was issued in December 1996 for a privatization project involving the construction of 840 new family housing units, the revitalization of 1,824 existing units, and the operation and maintenance of all units for a 50-year term. A contractor was initially selected in July 1997, and in February 1998, DOD notified the Congress of its intent to award the project. However, in April 1998, as the result of litigation, the Army subsequently decided to cancel the proposed award, reexamine the acquisition process for the Fort Carson project, and study corrective action alternatives. Although DOD officials did not estimate when these steps will be completed or when the project will again be ready for contract award, an additional 4 to 5 years will be needed after the award to finish construction and revitalization of the housing itself.

Implementation of the Privatization Initiative Raises Several Concerns

Several concerns have been raised about the privatization initiative, which will require continued management attention. For example, questions exist over the potential cost savings from privatization compared with traditional military construction projects. To estimate and compare the government's long-term costs for a housing project financed through the privatization initiative and through traditional military construction methods, the services prepare life-cycle cost analyses. However, DOD has not developed a standardized methodology for the services to use in performing the analyses. While DOD is working on such a methodology, it has not established milestones and a specific implementation date. Until standardization is achieved, the services' analyses may not be prepared consistently and may use assumptions and estimates that do not result in reliable cost comparisons.

GAO reviewed the services' life-cycle cost analyses for two proposed privatization projects, Fort Carson and Lackland Air Force Base, Texas, and found that the savings estimated to be achieved by using the privatization approach will be considerably less than that estimated by the services. For example, in comparison to military construction funding, the services had estimated that privatization will save about \$197 million, or 24 percent, at Fort Carson and about \$42 million, or 29 percent, at Lackland. GAO made adjustments to the services' analyses because some project costs had been excluded, some cost estimates were not based on actual budgeted amounts, and the 1998 Office of Management and Budget discount rate was not used to adjust for the time value of money. With the adjustments, estimated cost savings over the planned 50-year terms of the privatization agreements will be about \$54 million, or about 7 percent, at Fort Carson and about \$15 million, or about 10 percent, at Lackland.

Another concern has been the long-term nature of many proposed privatization agreements—usually 50 years. In an April 1997 report on the privatization initiative, the Center for Naval Analyses discussed several risks associated with long-term agreements. The report noted that when rents are fixed at levels other than market rates, such as in the planned Fort Carson agreement where rent will equal a member's housing allowance, a contractor has little economic incentive to maintain the property. The contractor can increase profits by limiting maintenance and repairs and can cut costs by hiring less qualified managers and staff and using inferior supplies. In short, under fixed-rent arrangements, contractors may have an incentive to cut services in ways that, although difficult to predict, could erode the quality of life for residents. To help ensure adequate contractor performance, DOD plans to include

maintenance standards, modernization schedules, required escrow accounts, and other safeguards in each privatization agreement. However, enforcing the agreements could be difficult, time-consuming, and costly.

An additional concern of long-term privatization projects, as well as for projects financed with traditional military construction funds, is whether the housing will be needed over the life of the projects. DOD housing officials stated that accurate forecasts of housing needs beyond 3 to 5 years cannot be assured. Yet, without this assurance, risks increase that all of the units will not be needed over the 50-year term of some proposed agreements. If units are not rented by the military, privatization agreements provide for civilians to rent the units even if the units are located on an installation. The matter of civilians living on base raises some questions that have not been fully answered by DOD. For example, if civilians rented privatized housing units on base, would security concerns be increased at some installations and would the government be required to pay education impact aid to the community for each civilian child?

Privatization Initiative Can Be Better Integrated With Other Elements of DOD's Housing Program

Although the privatization initiative provides a powerful new option for addressing DOD's housing problem, it is only one of several tools available to meet the housing needs of servicemembers and their families. DOD can best hope to maximize the advantages from the initiative and minimize total housing costs if it ensures that (1) accurate determinations are made of housing needs and the ability of the local communities to meet these needs at each installation, (2) maximum use of existing private sector housing is achieved in accordance with existing DOD housing policy, and (3) decisions on the structure of housing allowances and housing construction are made in concert with each other. Although each of these elements is ostensibly part of DOD's overall housing strategy, DOD has tended to view and manage these elements separately, rather than as part of a well-integrated strategy.

First, an accurate assessment of housing requirements is the foundation upon which construction decisions should be based if DOD is to minimize costs and avoid building or revitalizing housing that is not needed. Yet, the services have not corrected long-standing weaknesses in their housing requirements determination processes, which often underestimate the ability of local communities to meet military housing needs and tend to result in a self-perpetuating requirement for government housing. A 1996 GAO evaluation of the housing requirements analyses for 21 installations showed that methodology problems understated the ability of the private

sector to meet military needs at 13 installations. DOD has recognized this problem, and in December 1997, it convened a working group that included representatives from each service to examine the services' housing requirements determination processes. However, milestones for the working group and for implementing improvements to the requirements processes had not been developed as of March 1998.

Second, maximizing the use of existing housing in local communities—DOD's stated policy—is important to contain costs. According to GAO's estimates in 1996, total annual costs to the government were about \$5,000 less for a military family that lived in local community housing instead of government-owned housing. Yet, DOD and the services have not taken full advantage of this policy. For example, the Army and the Air Force have reported that the communities surrounding many military installations could, in fact, meet thousands of additional family housing requirements, thus reducing the need for government housing. In addition, providing comprehensive housing referral services to servicemembers has proven to be an effective means of promoting greater use of community housing. The Navy, for example, has pursued a more aggressive, or enhanced, approach to housing referrals to help families find suitable housing since 1994. Working with local landlords and apartment managers, the Navy in many cases has obtained preferences for military families such as reduced rental rates, waiving of some rental fees and deposits, and unit set-asides in which certain vacancies are offered to military families before they are offered to civilians. More aggressive programs by the other services, similar to the Navy's approach, could have the effect of reducing the need for new construction, whether it be through privatization or traditional military construction.

Third, decisions related to housing allowances and military housing construction should be made in concert, rather than in isolation, with each other. Effective coordination between the two DOD offices that separately manage housing allowances and the privatization initiative is important since changes in housing allowances could affect the amount of local housing that is affordable to military families and significantly affect privatization agreements in which the rental rates are equal to the servicemembers' housing allowance. Yet, when a new allowance program that will index housing allowances to local housing costs was developed in 1997, there was little coordination between the two DOD offices to ensure that the impact of the new program on the privatization initiative was fully analyzed.

In November 1997, DOD took an important step in its planning by directing the services for the first time to submit plans for eliminating inadequate family housing. The services were directed to submit plans that identify by installation, housing revitalization requirements and the potential for privatization. However, DOD did not provide written guidance for the services to use in determining these elements of a plan. Further, to optimally address housing problems, comprehensive plans are needed that integrate all elements of DOD's housing program, establish an improved process to more accurately determine housing requirements, maximize use of existing private sector housing, explore how referral services can be enhanced, and ensure better coordinated decisions on housing allowances and military construction.

Recommendations

To ensure that the privatization initiative is effectively integrated with other elements of DOD's housing program, GAO recommends that the Secretary of Defense expand the directive to the services concerning their plans for eliminating inadequate housing. Specifically, the Secretary should direct the services to prepare detailed, integrated housing plans that will (1) describe their plans for addressing long-standing weaknesses in their housing requirements determination processes, (2) demonstrate how they will attempt to maximize their reliance on community housing in accordance with DOD's stated policy, and (3) outline improvements in housing referral services. The plans should also include analyses of the estimated impact of the new housing allowance program on the availability of housing in local communities and show how housing allowances, traditional military construction, and the privatization initiative will be used in concert to meet DOD's housing needs in the most economical manner. Each service plan should include estimated milestones for achieving the goals of the plan.

GAO also recommends that the Secretary (1) establish a mechanism to promote more effective coordination between the offices responsible for housing allowances and housing management and (2) expedite DOD's effort, including establishing and monitoring milestones, to develop a standardized methodology for comparing life-cycle costs of proposed privatization projects with military construction alternatives.

Agency Comments

DOD provided comments on a draft of this report that are included in appendix VI. DOD partially concurred with GAO's report and recommendations. DOD's comments and GAO's evaluation of them are included in the report where appropriate.

With respect to the pace of the program, DOD stated that taking time to resolve critical program issues was necessary to ensure effective implementation of subsequent projects and that proceeding more rapidly would have created long-term problems for the program. GAO is not suggesting that DOD should have moved more quickly to implement this new program. As noted in GAO's conclusion, the initiative does represent a new way of doing business, and many issues needed to be resolved. GAO's intent was simply to factually report on the program's implementation.

With respect to integration of housing elements, DOD agreed with the need to integrate the privatization program with other elements of its housing program and outlined actions related to several elements of GAO's recommendation. DOD stated, however, that it would not turn its attention to integrating the various elements of the overall housing program until it had demonstrated success in the privatization initiative. GAO does not agree that DOD should wait to demonstrate success with the privatization initiative before focusing on integration. Better integration of housing elements is needed now to maximize the advantages of the initiative and ensure that housing is revitalized or constructed only at installations where the local communities cannot meet the military housing requirements. An expanded directive to the services in preparing their housing plans would help focus the services' attention on how they can use the full range of tools available to them in concert to address their housing problems in the most economical way.

With respect to a life-cycle cost analysis, DOD stated that it is developing a standard methodology for comparing costs between traditional military construction and privatization. However, it did not set a milestone for completing this task as GAO recommended. In view of the large number of projects proposed for privatization, GAO believes that expediting efforts to adopt a standardized methodology is important and that setting a milestone for completing this task can best ensure that this methodology is in place as soon as possible.

Finally, DOD agreed that coordination between the offices responsible for housing allowances and housing management is necessary but believes that existing coordination mechanisms are effective. GAO believes that the

uncertainty among service officials concerning the impact that the new housing allowances might have on the privatization program illustrates that better coordination is needed. A better understanding of this impact is important since the new housing allowance program could result in making more local community housing affordable to military families, thus reducing the need for privatized housing in some locations.

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Abbreviations

DOD	Department of Defense
HRSO	Housing Revitalization and Support Office
Milcon	Military Construction
OMB	Office of Management and Budget

Introduction

The Department of Defense (DOD) spends about \$8 billion annually to provide housing for families of active-duty military personnel. Seeking to provide military families with access to adequate, affordable housing, DOD either pays cash allowances for families to live in private sector housing or assigns families to government-owned or government-leased units. The housing benefit is a major component of the military's compensation package.

DOD Policy Manual 4165.63M states that private sector housing in the communities near military installations will be relied on as the primary source of family housing. About 569,000, or two-thirds, of the military families in the United States live in private housing. These families receive assistance in locating private housing from housing referral offices operated at each major installation and are paid housing allowances to help defray the cost of renting or purchasing housing in local communities. Housing allowances, which totaled about \$4.3 billion in fiscal year 1997, cover about 80 percent of the typical family's total housing costs, including utilities. The families pay the remaining portion of their housing costs out of pocket.

The remaining 284,000, or one-third, of the military families in the United States live in government-owned or -leased housing. These families forfeit their housing allowances but pay no out-of-pocket costs for housing or utilities. In fiscal year 1997, DOD spent about \$3 billion to operate and maintain government-owned and -leased family housing. In addition, about \$976 million was authorized to construct and renovate government family housing units in fiscal year 1997.

Unaccompanied and single enlisted personnel in lower paygrades normally are required by service policy to live in government-owned barracks when space is available. Single officers and single senior enlisted personnel usually can choose to live in civilian housing and receive housing allowances.

DOD's Housing Problem

According to DOD officials, the military services face three significant housing problems. First, in March 1998, a DOD official testified before the Congress that about 200,000 of the military-owned family housing units were old, had not been adequately maintained and modernized, and needed to be renovated or replaced. Using traditional military construction (Milcon) financing at current funding levels, DOD has estimated that over \$20 billion and 30 to 40 years would be required to accomplish

this task.¹ Second, according to DOD estimates, about 15 percent of the military families living in private housing are considered unsuitably housed primarily because of the high cost of the housing in relation to their housing allowances. Third, DOD officials have stated that most of DOD's 400,000 barracks spaces also are old, do not meet current suitability standards, and need major improvements estimated to cost about \$9 billion using traditional funding methods.

DOD has undertaken several initiatives to address these problems, including requests to the Congress for more housing construction funding and increased housing allowances to make privately owned housing more affordable to military members. The Congress approved DOD's request for a new housing allowance program starting in January 1998. The new allowance program replaced the Basic Allowance for Quarters and Variable Housing Allowance with a single allowance designed to better match the allowance amount with the cost of housing in each geographic area. Under the new program, housing allowances will be determined on the basis of costs for suitable civilian housing in each geographic area and allowance increases will be tied to growth in housing costs. According to DOD, the new allowance program should result in higher allowances in expensive housing areas and could result in lower allowances in some low-cost housing areas. The higher allowances in some areas could result in increasing the quantity of housing that is considered affordable to military families. Under the old program, housing allowances often did not keep up with changes in housing costs and in many cases servicemembers paid higher out-of-pocket costs than originally intended. The new allowance program is being phased-in over a 6-year period because of budget considerations and the desire to keep any allowance reductions gradual.

The Military Housing Privatization Initiative

To improve its existing family housing and barracks inventory more economically and at a faster rate, DOD concluded that a new initiative was needed. The new initiative, known as the Military Housing Privatization Initiative, called for new authorities to allow and encourage private sector financing, ownership, operation, and maintenance of military housing.

¹On the basis of our prior work, we recognize that DOD faces significant housing problems, but we do not fully agree with DOD on the magnitude of the problems. In a September 1996 report, Military Family Housing: Opportunities Exist to Reduce Costs and Mitigate Inequities (GAO/NSIAD-96-203, Sept. 13, 1996), we noted that the private sector can meet additional family housing requirements and eliminate the need to renovate or replace many military owned units. Our work also found that because DOD uses new construction standards to assess the condition of military owned housing units, many housing units that DOD classifies as inadequate are not dilapidated but only lack modern amenities such as a separate utility room or a carport.

In May 1995, DOD requested the Congress to approve a variety of new authorities that, among other things, would allow DOD to (1) provide direct loans and loan guarantees to private entities to acquire or construct housing suitable for military use, (2) convey or lease existing property and facilities to private entities, and (3) pay differential rent amounts in addition to the rent payments made by military tenants. The new authorities would also allow DOD to make investments, both limited partnership interests and stock and bond ownership, to acquire or construct housing suitable for military use and permit developers to build military housing using room patterns and floor areas comparable to housing in the local communities. The authorities could be used individually or in combination. Appendix I contains a complete list and description of the authorities.

The Congress approved the new authorities, and the initiative was signed into law on February 10, 1996.² However, the Congress limited the new authorities to a 5-year test period to allow DOD to assess their usefulness and effectiveness in improving the military housing situation. Based on the results of the test, the Congress will consider whether the authorities should be made permanent.

Potential Benefits From Privatization

The basic premise behind the initiative is for the military to take advantage of the private sector's investment capital and housing construction expertise. DOD has noted that the private sector has a huge pool of housing investment capital. By providing incentives, such as loan guarantees or co-investments of land or cash, the military can encourage the private sector to use private investment funds to build or renovate military housing.

Use of private sector capital can reduce the government's near-term outlays for housing revitalization by spreading costs, specifically increased amounts for housing allowances, over a longer term. DOD's goal is to have the private sector to invest at least \$3 in military housing development for each dollar that the government invests. By leveraging government funds by a minimum of 3 to 1, the military can stretch its available construction funds so that significantly more housing can be revitalized in comparison with traditional Milcon financing. DOD officials stated that, with leveraging, the housing problem could be solved with current funding levels in only 10 years. DOD also noted that privatization can reduce the average cost of military housing through the use of commercial specifications and

²The National Defense Authorization Act for Fiscal Year 1996 (Public Law 104-106, 110 Stat. 186).

standards and local building codes and practices. A DOD housing official stated that the military's cost for a house built with Milcon funding—about \$135,000, excluding land—is substantially higher than private industry averages, primarily due to government procurement practices and overly detailed specifications. Under Milcon financing, contractors normally are faced with specifications, standards, and housing sizes different from industry or local practices. As a result, some contractors do not compete for these jobs and those that do often raise their prices to cover the higher costs associated with the requirements. According to DOD, use of commercial building standards and practices can also reduce costs by increasing competition and by reducing developer risk because the homes are more marketable to nonmilitary families, if not used by servicemembers and their families.

Managing the Privatization Initiative

In September 1995, in anticipation of the enactment of the new authorities, DOD established the Housing Revitalization Support Office (HRSO) to facilitate implementation of the initiative. With a staff of 16 full-time personnel and support from consultants, HRSO is responsible for overseeing and assisting the services in using the new initiative. The individual services are responsible for nominating potential privatization projects; working with HRSO in reviewing projects and recommending which authorities should be used; preparing requests for proposals; and managing the contract competition, award, and implementation processes.

Under the privatization initiative, the Office of Management and Budget (OMB) and DOD have agreed on guidance regarding the amount that should be recognized and recorded as an obligation of DOD at the time a privatization agreement is signed. The guidance refers to this process as scoring. In this report, we use the word "scoring" to refer to the application of this guidance to agreements made under the privatization initiative.

Funding for the privatization initiative is accomplished through two funds established by the authorizing legislation—the DOD Family Housing Improvement Fund and the DOD Military Unaccompanied Housing Improvement Fund. The funds receive sums by direct appropriations and transfers from approved Milcon projects and from proceeds from the conveyance or lease of property or facilities. The two funds are used to implement the initiative, including the planning, execution, and administration of privatization agreements. The two funds must be managed separately and amounts in the two funds cannot be commingled.

Table 1.1 shows the sources and uses of funds in the DOD Family Housing Improvement Fund for fiscal years 1996 and 1997. No appropriations were made to the fund for fiscal year 1998.

Table 1.1: DOD Family Housing Improvement Fund Activity

	Dollars in millions		
	Fiscal year		
	1996	1997	Total
Additions to fund			
Appropriations	\$22.0	\$25.0	\$47.0
Transfers from Milcon		5.9	5.9
Total additions			\$52.9
Expenditures from fund			
Funding for projects	9.5	5.9	15.4
Administration and consultants	3.0	6.0	9.0
Request for proposal development	0.8		0.8
Total expenditures			\$25.2
Fund balance end of fiscal year 1997			\$27.7

Source: HRSO.

In fiscal year 1997, \$5 million was appropriated for the DOD Military Unaccompanied Housing Improvement Fund. About \$100,000 from this fund was used to pay for an Air Force study on developing privatized unaccompanied housing projects.

Objectives, Scope, and Methodology

Because it represents a new approach to improving military housing, we reviewed the implementation of the Military Housing Privatization Initiative to (1) measure progress to date, (2) assess issues associated with privatizing military housing, and (3) determine whether the initiative is being integrated with other elements of DOD's housing program. We performed work at HRSO and the DOD offices responsible for housing management and housing allowances. We also performed work at the Air Force, the Army, the Navy, and the Marine Corps headquarters offices responsible for implementing the initiative and at the OMB office responsible for reviewing privatization agreements. At each location, we interviewed responsible agency personnel and reviewed applicable policies, procedures, and documents.

To measure implementation progress and assess issues associated with privatizing military housing, we reviewed DOD's and the services' implementation plans, compared the plans to progress made, and explored reasons for differences. We discussed potential barriers and concerns about the privatization initiative with DOD and service officials to obtain their views and to determine how they were dealing with the concerns. We also reviewed estimated cost savings from the initiative and examined the assumptions and estimates the services used in preparing life-cycle cost analyses for proposed privatization projects at Fort Carson, Colorado, and Lackland Air Force Base, Texas. In addition, we visited Navy privatization projects at Corpus Christi, Texas, and Everett, Washington, that were implemented under a previous initiative to test the use of limited partnerships to improve housing in the Navy. At each site, we toured the new housing units, reviewed occupancy statistics and rental costs, and discussed with local service officials their views of the initiative.

To determine whether the new initiative is being integrated with other elements of DOD's housing program, we reviewed DOD's and the services' housing policies, programs, initiatives, and plans. We also examined previous reports and studies related to military housing issues, reviewed DOD and service housing organization and management structures, and discussed the need for well-integrated housing plans with DOD, service, and OMB officials.

We conducted our review between June 1997 and March 1998 in accordance with generally accepted government auditing standards.

Privatization Is Off to a Slow Start and Requires Continued Management Attention

Initially optimistic about how quickly the new privatization authorities could solve the housing problem, DOD officials now recognize that implementation will be slower than expected. For a variety of reasons, final privatization agreements have not been signed for any proposed housing projects initiated since the authorities were signed into law in February 1996. DOD officials believe that progress may speed up after the first few projects are approved; however, each project is unique and will require individualized planning and negotiation. In 1997, DOD revised its initial goal for solving the DOD housing problem in 10 years by delaying the target 4 years, to fiscal year 2010. Other issues, such as potential savings from privatization, risks associated with long-term privatization agreements, and use of the authorities to improve barracks, are also of concern and will require continued monitoring and attention from DOD management.

Implementation Has Been Slower Than Expected

In May 1995, DOD first announced its proposal to use private sector financing and expertise to improve military housing. In a May 8, 1995, press release, DOD stated that the quality of military housing had declined for many years because of a lack of priority and because earlier attempts at solutions ran into regulatory or legislative roadblocks. However, with congressional approval of new authorities to acquire help from the private sector, DOD stated that its 30-year housing problem could be solved in 10 years. DOD officials repeated this claim in subsequent testimony before several congressional committees.

Anticipating congressional approval of the initiative, the Secretary of Defense established a fiscal year 1996 goal to use the new authorities to execute projects affecting at least 2,000 family housing units and 2,000 barracks spaces. During congressional hearings in March 1996 and 1997, DOD officials stated that about 8 to 10 projects with up to 2,000 family housing units should be awarded within the next year and that the goal was to increase the number of units planned for construction and revitalization to 8,000 in fiscal year 1997 and to 16,000 units in fiscal year 1998. This planned ramp-up would have to actually occur and continue for DOD to solve its housing problem within the initial 10-year time frame, by fiscal year 2006.

Although the initial goals were aggressive and DOD actively pursued implementation of the new initiative, progress has been slow. Since the authorizing legislation was signed in February 1996 through the end of February 1998, no new agreements were finalized to build or renovate

military housing. In January 1998, DOD was actively considering more than a dozen projects for privatization and many others were in the early planning stages. However, only one, Lackland Air Force Base, apparently is close to contract signing, which is the beginning point for implementing housing improvements. Appendix II shows details of the projects being considered in January 1998.

DOD officials often point to two Navy projects as the first examples of improvements under the initiative. The projects—404 new units at Corpus Christi, Texas, and 185 new units at Everett, Washington—were constructed off base on private property under limited partnership agreements between the Navy and private developers. However, the authority for these projects was not the legislation that established the initiative, but was legislation approved in October 1994. This legislation gave only the Navy authority to test the use of limited partnerships in order to meet the housing requirements of naval personnel and their dependents.¹ Appendix III provides details on the Navy's limited partnership agreements at Corpus Christi and Everett.

The proposed Fort Carson privatization project illustrates the slow progress in implementing an agreement under the initiative. In October 1993, the Army requested \$16.5 million in Milcon funds to replace 142 family housing units at Fort Carson in fiscal year 1995. The project was approved, but construction did not begin because the Army became interested in leveraging the funds through privatization to finance a much larger housing improvement effort at the installation.

A HRSO team visited Fort Carson in December 1995, and after study and analysis, concluded in June 1996 that government housing at Fort Carson was a good candidate for privatization. The proposed privatization project—to construct 840 new family housing units, revitalize 1,824 existing units, and operate and maintain all of the units for a 50-year term—was approved in August 1996, and the request for proposal was issued in December 1996 for offers from the private sector to accomplish the requirements of the project. A contractor was selected in July 1997, and final negotiations began prior to contract award. On February 10, 1998, DOD notified the Congress of the Army's intent to transfer Fort Carson's 1995 Milcon appropriation into the DOD Family Housing Improvement Fund and to award the contract. However, in April 1998, as the result of litigation, the Army decided to cancel the proposed award,

¹See section 2803 of Public Law 103-337, October 5, 1994. The authority to use limited partnerships is now available to all services under the 1996 legislative initiative.

reexamine the acquisition process for the Fort Carson project, and study corrective action alternatives. Although DOD officials did not estimate when these steps will be completed or when the project will again be ready for contract award, DOD estimated an additional 4 to 5 years will be needed after the award to finish construction and revitalization of the housing itself.

In July 1997, DOD revised its target date for solving its housing problem when it issued planning guidance for fiscal years 1999 through 2003. The guidance directed the military services to plan to revitalize, divest through privatization, or demolish inadequate family housing by or before fiscal year 2010, 4 years later than the original target.

Reasons for Slow Progress

According to DOD officials, privatization implementation has been slower than expected primarily because the initiative represents a new way of doing business for both the military and the private sector. Initially, HRSO had to develop protocols for site visits and new tools and models to assess the financial feasibility of using the various authorities to help solve the housing problem at an installation. Then, as detailed work began on developing potential projects, many legal issues had to be addressed relating to the applicability of the Federal Acquisition Regulations and the Federal Property Regulations to the projects. Also, new financial and contractual issues had to be resolved such as establishing loan guarantee procedures to insure lenders against the risk of base closure, downsizing, and deployment; developing a process to provide direct loans to real estate developers; and creating documents for conveying existing DOD assets to developers.

HRSO officials stated that the process has been slow to obtain concurrence on the details of the proposed Fort Carson and Lackland project agreements from lawyers representing the government, the developers, and the potential lenders. In addition, the officials noted that because the initiative has had high visibility both within and outside of DOD, much care and attention were devoted to ensuring that no mistakes were made as the initial agreements were developed. However, once the first one or two deals are completed, the officials believe that subsequent deals should proceed much faster.

Another factor that slowed implementation was initial disagreement between DOD and OMB on how projects that used the various authorities should be scored. Discussions between the agencies continued for several

months until a written agreement was adopted on June 25, 1997, which provided detailed scoring guidance applicable to the first 20 privatization projects. After these projects are completed, the agreement will be reviewed to determine whether any changes are needed.²

Savings From Privatization Appear Modest

Privatization allows DOD to address its military housing problem more quickly by securing private sector financing of housing improvements. However, whether privatization also saves the government money in the long term, and if so, how much money are questions that have not been answered.

Under traditional Milcon financing of military housing, the military pays the initial housing construction or renovation costs and then pays the annual costs to operate, maintain, and manage the units. The military does not pay monthly housing allowances since occupants of the units forfeit their allowances when living in government-owned housing. Under most proposed privatization projects, the military initially uses some funds to secure an agreement with a private developer and then pays monthly housing allowances to the servicemembers that occupy the housing, since the housing is not government-owned. The servicemembers use their housing allowances to pay rent to the developer. In addition, under most privatization options, the military continues to pay some housing management costs for servicemember referral services and for contract oversight. Thus, although the exact budgetary consequences from use of the various privatization authorities are not known, it appears that privatization largely results in a shift in funding from military housing construction, operations, and maintenance accounts to military personnel accounts to pay for additional housing allowances.

Performing accurate cost comparisons between privatization and Milcon alternatives is difficult because the comparisons involve many variables and assumptions. However, one key issue in the comparisons is whether the housing under each alternative is the same. To illustrate, developers of projects under the initiative might use local building practices and standards to construct or revitalize housing that may be different in size and amenities from that constructed under Milcon building standards and specifications. For example, HRSO officials stated that privatized housing

²Because planning for the first two projects, Fort Carson and Lackland Air Force Base, was well underway before the scoring guidance agreement was adopted, OMB agreed that the guidance would not apply to these projects. As a result, the military can provide utilities at no cost to the developers or the military occupants in these projects without incurring a scoring impact. In all other privatization agreements, the cost of utilities will be scored if the military pays.

for married junior enlisted personnel based on local standards may result in garden-style apartments with no carports or garages. Normally, Milcon housing for married junior enlisted personnel results in larger townhouse type units with a carport or a garage. Because of such differences, a cost comparison between Milcon and privatization alternatives may not always result in an analysis of comparable housing.

HRSO and service analyses of potential privatization projects have primarily focused on the financial feasibility of the deals. In other words, the analyses attempt to determine whether deals can be made that are attractive to developers while still meeting DOD's leveraging goals. HRSO did not initially focus on comparing the long-term or life-cycle costs of a potential privatization project with the costs to perform the same project using traditional Milcon financing.

Nevertheless, prior to finalizing a privatization agreement, the services perform a life-cycle analysis comparing project costs using both alternatives. HRSO, however, has not provided guidance for how these analyses should be completed, including what costs to consider and what assumptions to use. As a result, the services' life-cycle analyses may not be prepared consistently and may use assumptions and estimates that do not result in reliable cost comparisons. HRSO officials stated that this is a concern and that they have tasked a consultant to develop a standard methodology for performing the analyses. Although milestones and a specific implementation date have not been established, HRSO officials stated that the services will be required to use the standardized methodology when it is completed and approved by HRSO.

We reviewed the services' life-cycle cost analyses for two proposed privatization projects at Fort Carson and Lackland Air Force Base to compare estimates of the government's long-term costs for housing financed with Milcon funds and through the privatization initiative. The Fort Carson analysis, which was included in the February 10 congressional notification of DOD's intent to enter into the Fort Carson agreement, estimated that over the 50-year term of the agreement privatization will cost about \$197 million, or 24 percent, less than Milcon. The Lackland Air Force Base analysis, which might be revised before the contract is awarded, estimated that privatization will cost about \$42 million, or 29 percent, less than Milcon.

In our review, we made adjustments to the services' analyses because some project costs had been excluded, some cost estimates were not

based on actual budgeted amounts, and the 1998 OMB discount rate was not used to adjust for the time value of money. We made no adjustments for possible differences in the size or amenities of the housing resulting from each alternative. As shown in table 2.1, our review showed that although privatization was less costly for each project, the overall estimated cost savings to the government were considerably less than the services' estimates—about \$54 million less, or about 7 percent, at Fort Carson and \$15 million less, or about 10 percent, at Lackland. Appendixes IV and V provide details on the assumptions used in DOD's and our review of Fort Carson and Lackland life-cycle cost estimates.

Table 2.1: Life-Cycle Cost Comparison for Two Privatization Projects

Project description	Estimated total costs					
	Service estimate			Our estimate		
	Privatization	Milcon	Difference	Privatization	Milcon	Difference
Fort Carson: construct 840 new units, revitalize 1,824 existing units, operate and maintain for 50 years.	\$640	\$837	\$197	\$679	\$733	\$54
Lackland Air Force Base: construct 420 new units, operate and maintain for 50 years.	\$103	\$145	\$42	\$130	\$145	\$15

With no other cost comparisons to review at this time and with each future privatization agreement having unique circumstances and costs, it is difficult to draw conclusions on the extent of cost savings available from the privatization initiative. However, Army and Air Force officials have stated opinions that long-term savings to the government through the privatization initiative may be minimal. For example, an Army housing official stated that, although privatization can help solve the Army's housing problems faster than Milcon, privatization does not significantly reduce the Army's total costs because reduced family housing costs are offset by higher personnel costs, which are used to pay for additional housing allowances. Also, the Air Force completed a hypothetical analysis comparing life-cycle costs to revitalize 670 family housing units through privatization and Milcon. The analysis showed that there would be less than a \$1-million difference between the two alternatives in total costs to the government over the life of the project.

Long-Term Privatization Agreements Include Concerns

According to DOD officials, most of the potential privatization projects now under consideration call for long-term agreements between DOD and the developers. Many proposed deals are for 50 years with an option for another 25 years. HRSO officials stated that long-term agreements are needed to make the proposed projects financially feasible by providing a long-term cash flow to cover the developers' investment costs for new construction and revitalization.

To illustrate, the privatization proposal for Fort Carson calls for a whole-base deal in which the developer will revitalize existing units, construct new units, and operate and maintain all units for 50 years. Land related to the project will be leased to the developer. At the end of the 50-year term, providing that the government does not exercise an option to extend the agreement for another 25 years, the developer will be required to vacate the premises and may be required to remove the housing. The developer is expected to invest about \$220 million to construct and revitalize the units and will recoup this cost, as well as the operating and maintenance costs, excluding utilities, from the rents paid by the occupants over the term of the agreement. Military families have first preference in renting the units and will pay rent equal to the members' housing allowances. If military families do not rent the units, the units can be rented to civilians. DOD plans to provide a loan guarantee for funds that the developer borrows to construct and revitalize the units. However, the loan guarantee only covers the risks of base closure, deployment, and downsizing. In the event of a base closure default, the government could be obligated to pay off the loan and assume ownership of the project for disposal.

Forecasts of Housing Needs

Long-term privatization agreements present several concerns that require careful consideration. For example, before the military invests in a long-term housing project through a privatization agreement or traditional Milcon funding, the military should know with a high degree of certainty the installation's future housing needs. To do this, the military must first determine whether the installation will be needed in the future; specifically, whether the installation is a likely candidate for closure during any future reductions in military infrastructure. If the installation is predicted to be needed, then the military must forecast (1) the installation's future mission, military population, and family housing requirement; (2) future private housing availability and affordability in the local community; and (3) future military family housing preferences for on-base or off-base housing.

According to several service officials, making accurate forecasts of these variables beyond a 3- to 5- year period cannot be assured. Yet, without long-term assurance that the privatized housing will be needed, risks increase that the service will not need all, or any, of the housing over the term of the agreement.

Contractor Performance

Another concern associated with long-term privatization agreements is the potential for poor performance or nonperformance by the contractors. A major concern, particularly for on-base privatization projects, is whether contractors will perform housing repairs, maintenance, and improvements in accordance with the agreements. Although maintenance standards, modernization schedules, required escrow accounts, and other safeguards will be included in the agreements, enforcing the agreements could be difficult, time-consuming, and costly.

In an April 1997 report on the privatization initiative, the Center for Naval Analyses discussed concerns with long-term agreements.³ The report noted that when rents are fixed at levels other than market rates, such as in the proposed Fort Carson and Lackland agreements where rent equals a member's allowance, a contractor has little economic incentive to maintain the property. The contractor can increase profits by limiting maintenance and repairs and can cut costs by hiring less qualified managers and staff and using inferior supplies. In short, under fixed-rent arrangements, contractors may have an incentive to cut services in ways that, although difficult to predict, could erode the quality of life for servicemembers.

The report also noted that long-term agreements contain disincentives that can occur late in the agreement. For example, the report stated that the long-term financial incentive for the developer during the last 20 years may be to disinvest so that the value of the physical assets foregone at the end of the term has been drained by use. Further, if the value of the units declines and military families do not rent the units, the potential exists for civilians to move on base, paying lower rents and creating an on-base slum.⁴

³Housing Benefits: Analysis of Public-Private Authorities, Center for Naval Analyses, CRM 97-27, April 1997.

⁴Under proposed privatization agreements, military families will not be required to occupy privatized housing.

Prospects of Civilians Living on Base

Privatization agreements provide for civilians renting the housing units if they are not rented by military families. Long-term agreements increase the potential that civilians will eventually live on base. For example, over a period of years, housing allowances could increase and more community housing could become available, making it more likely that military families would choose to live off base. In this circumstance, the contractor could rent vacancies to civilians.

In some locations, installation commanders may welcome civilians living on base. However, in other locations, the civilians may not be welcomed. Marine Corps officials stated that most Marine installation commanders did not want civilians living on base because of security reasons and because of the tradition of having a military housing community available to members and their families.

In addition to possible security concerns at some installations, the prospect of civilians living on base also raises some questions that have not been fully answered. For example, if civilians rented privatized housing units on base, would the government be required to pay education impact aid to the community for each civilian child,⁵ and would law enforcement responsibilities be more complicated because both local community and base police could be involved in matters related to on-base civilian tenants?

Using Privatization to Improve Unaccompanied Housing Is Unlikely

According to DOD and service officials, there would be little financial advantage in using privatization to improve unaccompanied housing. The primary problem lies in the services' mandatory assignment policies for single junior enlisted personnel and the budgetary scoring impact from mandatory assignments.

The current policy in each service requires mandatory assignment of single junior enlisted members to the barracks, providing that space is available. According to DOD officials, most military leaders strongly support this policy because they believe that such assignment provides for military discipline and unit integrity. However, in accordance with the guidance established for recording obligations under the privatization initiative, mandatory assignment of military personnel to privatized housing

⁵Education impact aid is paid to local governments to help cover the cost of educating dependents of military members. The impact aid for each dependent is significantly higher for students that live with their families in government housing because government housing is not subject to local property taxes. When military families live in housing in the local communities, a much smaller amount is paid for each student because the housing is subject to local property taxes.

constitutes an occupancy guarantee, which results in a government obligation to pay rental costs over the entire term of the agreement. Thus, when a privatization project includes an occupancy guarantee, DOD must set aside funds to cover the value of this guarantee up front. Because the funds required to cover the guarantee could approximate the amount of funds required under traditional military construction financing, funding for a privatized barracks project would not meet DOD's goal to have the private sector to invest at least \$3 for each dollar the government invests.

This issue is not a problem in military family housing because mandatory assignments normally are not made. In most cases, married members in all paygrades can decline government-owned housing, if available, and decide where they want to live. Because installation commanders do not appear to be willing to change the current policy regarding barracks assignments, privatizing unaccompanied housing does not appear to be a financially viable alternative.

An additional barrier to privatized barracks cited by DOD officials is a lack of funding to pay for increased housing allowances. If privatized, occupants would begin receiving housing allowances to pay rent. In family housing, there is a separate budget account for housing operations and maintenance that can provide a funding source to help pay for increased allowances. However, barracks operations and maintenance is not funded by a similar separate account. Instead, barracks operations and maintenance is funded from the overall base operating budget. According to service officials, this budget account often is underfunded and, therefore, does not have sufficient funds to help pay for increased housing allowances for unaccompanied personnel.

Of the \$5 million appropriated for the Military Unaccompanied Housing Improvement Fund in fiscal year 1997, about \$100,000 was used to pay for an Air Force study on developing privatized unaccompanied housing projects. Because of the barriers to developing privatized barracks projects, it is uncertain whether the remaining funds will be used as seed money for privatized unaccompanied housing projects.

Conclusions

DOD officials are aware of the issues discussed in this chapter. Since the beginning of the privatization initiative, DOD has attempted to speed implementation and address issues associated with potential savings from privatization, risks associated with long-term agreements, and using the authorities to improve barracks. However, the initiative does represent a

new way of doing business, and DOD has been appropriately deliberate in its implementation. As implementation continues and progress is made, continued management attention can help ensure that benefits from the initiative are realized, potential risks are minimized, and program changes are adopted when needed. DOD has already recognized the need to standardize the methodology the services use in preparing life-cycle analyses comparing costs of privatization and Milcon alternatives. However, DOD needs to ensure that a standardized methodology is developed and implemented as quickly as possible. Without a standard methodology, DOD officials cannot be assured that the services' estimates of cost differences between the two alternatives for proposed projects are consistent and reliable.

Recommendation

We recommend that the Secretary of Defense expedite HRSO's effort to develop a standardized methodology for comparing life-cycle costs of proposed privatization projects with military construction alternatives. This action should include establishing and monitoring milestones for the development and implementation of the methodology.

Agency Comments and Our Evaluation

In commenting on a draft of this report, DOD noted that the time it has taken to initiate the program was appropriate and necessary to resolve critical program issues that will ensure timely and effective implementation of all subsequent projects. DOD stated that proceeding more rapidly would have created major long-term problems for the program. We are not suggesting that DOD should have moved more quickly to implement this new program. As noted in our conclusion, the initiative does represent a new way of doing business, and many issues needed to be resolved. Our intent was simply to factually report on the program's implementation. The fact remains that DOD established several goals for the program, which included having 16,000 units planned for construction by fiscal year 1998. To date, no units have been constructed or revitalized and it is unlikely that any units will be before the end of fiscal year 1998. Moreover, although DOD expects implementation to accelerate once it completes its first projects, we believe it is important to recognize that each proposed project will come with its own unique circumstances and that it may be unrealistic to assume that the program can be greatly accelerated.

With respect to life-cycle cost comparisons of family housing construction under Milcon and privatization, DOD noted that although our life-cycle cost

savings estimates under privatization for Fort Carson and Lackland Air Force Base are less than DOD's estimates, the savings are still significant. DOD also stated that the type of economic analysis by which we made its estimates between the two alternatives tend to obscure an important underlying reality—that family housing military construction funding is not available at the levels estimated in the comparisons. We did not develop a unique cost analysis for these two projects but rather used the cost analysis developed by the military services. As we stated in our report, we made adjustments to the services analyses because some project costs had been excluded, some cost estimates were not based on actual budgeted amounts, and the 1998 OMB discount rate was not used to adjust for the time value of money. Also, the fact that DOD has required a life-cycle cost comparison for all proposed projects suggests that it, too, believes that life-cycle cost analyses are necessary to accurately evaluate housing alternatives. Without a standardized life-cycle cost methodology in place, privatization projects could be undertaken that are more costly than other alternatives. Our intent was simply to provide an independent life-cycle cost analysis as a check against the DOD estimates. Lastly, we agree that military construction funds would not likely be available at the same levels available under privatization since the privatization initiative seeks to leverage government funds by a minimum of three to one.

DOD partially concurred with our recommendation regarding a standardized methodology for comparing life-cycle costs of proposed projects under both alternatives. DOD agreed that a consistent presentation of life-cycle cost comparisons is desirable and necessary and stated that it is developing such a standard methodology for application to all future projects. Our recommendation, however, was aimed at expediting this effort, and DOD did not provide specific information concerning a schedule for developing and implementing its standardized methodology. In view of the large number of projects that the services have proposed for privatization, we believe that adopting a standardized methodology as soon as possible is important. Use of a standardized methodology across service lines would provide a consistent way of comparing costs and permit more informed decisions about the relative merits of housing alternatives.

Privatization Initiative Can Be Better Integrated With Other Elements of DOD's Housing Program

The privatization initiative is only one of several tools, including housing allowances and traditional military construction, available to meet the housing needs of servicemembers and their families. To be most effective, the initiative needs to be integrated with the other tools and elements of an overall housing strategy. For example, to maximize the advantages from the initiative and minimize total housing costs, privatization needs to be part of a strategy that ensures (1) accurate determinations of housing needs and the ability of the local communities to meet these needs at each installation, (2) maximum use of private sector housing in accordance with DOD housing policy, and (3) coordinated decisions on the structure of housing allowances and housing construction. Although DOD and the services have tended to view and manage these elements separately, rather than as part of a well-integrated strategy, DOD has recently taken some steps to improve planning for eliminating inadequate family housing. However, to optimally address housing needs, additional steps can be taken to develop comprehensive plans that integrate all elements of DOD's housing program.

Accurate Housing Requirements Determinations Provide Starting Point

Foundational to an integrated housing plan is a process that accurately determines the services' housing needs and the ability of the local communities to meet those needs at each installation. Accurate requirements analyses can help ensure that government housing, whether Milcon or privatized, is provided only at installations where the local communities cannot meet the military's family housing needs, as specified by DOD policy. However, our prior work and the work of others have found significant, long-standing problems in the processes the services use to determine their housing requirements.

For example, in our 1996 report on military family housing, we noted that DOD and the services relied on housing requirements analyses that (1) often underestimated the private sector's ability to meet family housing needs and (2) used methodologies that tended to result in a self-perpetuating requirement for government housing. Our 1996 evaluation of the housing requirements analyses for 21 installations showed that methodology problems understated the ability of the private sector to meet military needs at 13 of the installations. The Congressional Budget Office, the Center for Naval Analyses, and others have reported similar problems with the services' housing requirements determination processes.

In our report, we recommended that DOD revise the housing requirements determination process by considering the results of an on-going DOD Inspector General's review of the services' requirements processes. In response to our recommendation, DOD stated that it would consider the results from the Inspector General's review and would implement accepted recommendations. The Inspector General's report was issued in October 1997. The report stated that "DOD and Congress do not have sufficient assurance that current family housing construction budget submissions address the actual family housing requirements of the Services in a consistent and valid manner."

The Inspector General recommended developing a DOD standard process and standard procedures to determine family housing requirements. In response, DOD officials stated that a working group, including representatives from each service, was convened in December 1997 to address the problems in the housing requirements determination process. However, milestones for the working group and for implementing improvements to the requirements process had not been developed at the time of our review in March 1998.

Maximizing Use of Civilian Housing Has Been Most Economical

Integrated housing plans founded on accurate requirements determinations can help ensure implementation of DOD's policy of relying first on existing private sector housing to meet the military's family housing needs. Implementation of this policy has been the most economical form of privatization. When servicemembers are paid housing allowances and families live in suitable private housing in local communities, the government's cost for housing is minimized and the military is effectively out of the housing business. To illustrate, in our 1996 housing report, we compared the government's costs to provide housing for a military family in government-owned and private sector family housing units in fiscal year 1995. The comparison showed that the government spent an average of \$4,957 less for each family that lived in private sector housing. The difference resulted because a typical family living in private housing paid \$2,016 of its housing costs out of pocket and the government paid \$1,416 less in education impact aid because private housing is subject to local taxes. The remaining amount represented the estimated difference in the annual cost of a housing unit constructed, operated, and maintained by the military and a unit constructed, operated, and maintained by the private sector.

There are other advantages to relying on private housing. In the current environment of constrained defense budgets and DOD's requests for future rounds of base closures, the short-term flexibility offered by maximum use of private sector housing appears preferable to the long-term commitments required by Milcon and most privatization agreements. Existing private sector housing also can offer military members a greater selection of housing options to fit their needs instead of limiting them to what is available in military housing.

The services have not always maximized use of existing private sector housing in accordance with the DOD policy. In our 1996 report, we stated that the communities surrounding many military installations could meet thousands of additional family housing needs. For example, the Army reported in 1996 that over 34,000 government family units at 59 Army installations were occupied but were considered surplus—meaning that the communities near these installations had affordable housing available that could meet these requirements. Similarly, the Air Force reported that over 4,000 government units at 13 Air Force installations were surplus. The Navy and the Marine Corps did not accumulate comparable housing information on their installations.

We are not suggesting that the scope of any planned privatization project is not justified. A sufficient quantity of affordable private sector housing is not available at many U.S. military installations. We do believe, however, that long-range, integrated housing plans can provide the focus needed to ensure that maximum use is made of civilian housing before new investments are made in military housing. In particular, when local communities can meet additional military family housing requirements, this focus can ensure that government housing units are closed when the units reach the end of their economic life rather than renovated or replaced through Milcon or privatization. By ensuring that privatization authorities are used only where needed, the military's risks are reduced and costs are minimized for incentives to private developers, education impact aid, on-base housing utilities, and police and fire support for on-base housing.

Navy's Enhanced Housing Referral Services Have Expanded Private Housing Opportunities

Providing comprehensive housing referral services to servicemembers has proven to be an effective means of promoting greater use of existing private sector housing. Effective referral services that result in placing more military families in suitable private sector housing could reduce the need for new construction, whether it is accomplished through

privatization or Milcon. DOD policies currently require each installation to assist servicemembers and their families in finding suitable private housing in the local communities. The Navy, however, has adopted a more aggressive, or enhanced, approach to housing referrals to help families find suitable housing.

According to Navy officials, the Navy has pursued enhanced housing referral services since 1994. Under this approach, Navy housing officials work with local landlords and apartment managers to obtain preferences for military families such as reduced rental rates, waiving of some rental fees and deposits, and unit set-asides in which certain vacancies are offered to military families before they are offered to civilians. For example, Navy housing officials at Everett, Washington, stated that they had signed agreements with 39 housing complexes that had resulted in providing affordable housing for about 350 servicemembers and their families. This approach also includes welcome centers, which servicemembers can visit to obtain detailed information on area housing and receive personal assistance in securing suitable housing.

DOD officials stated that the Navy's approach has been successful and probably would be beneficial if adopted by the other services. However, the officials stated that there is no current initiative to implement enhanced referral programs in the other services.

Use of Housing Allowances Is a Key Tool but Requires Coordination

Long-range, integrated plans can emphasize the use of housing allowances as a key tool in addressing the military's housing problem. Adequate housing allowances can help military members and their families secure suitable housing in the local communities, reducing the need for on-base housing. However, because use of allowances to address the services' housing problems can directly affect the use of other tools, such as privatization and military construction, coordination is required to manage the impacts. This coordination has not always occurred. In some cases, DOD initiatives relating to housing allowances and to construction and management of military family housing have been viewed and managed separately rather than in combination to achieve a synergistic impact.

One reason for this is that separate DOD organizations manage these two key components of the family housing program. Housing allowances are the responsibility of the Under Secretary of Defense for Personnel and Readiness and primarily are managed centrally at DOD headquarters by the organization responsible for all compensation issues, including basic pay

and other types of allowances. Appropriations for housing allowances are included in the services' military personnel accounts. Construction, management, and privatization of military housing are the responsibility of the Under Secretary of Defense for Acquisition and Technology. This organization establishes overall DOD housing policy and delegates primary housing management responsibility to the individual services, their major commands, and individual installations. This organization is responsible for most housing initiatives, including the Milcon program and the privatization initiative. Appropriations for the family housing program are included in the services' military construction and family housing accounts.

DOD officials stated that the two organizations work together and coordinate on matters relating to housing allowances. However, each organization is responsible for its own initiatives, and an overall strategy has not been developed to ensure optimum integration of all initiatives. For example, when a new housing allowance program was developed, there was little discussion between the two organizations on how the program would affect the privatization initiative, even though allowance changes could affect not only the affordability of existing private sector housing but also privatization agreements where rental rates are equal to the servicemembers' housing allowances.

The Congress approved DOD's request for major changes to DOD's housing allowance program starting in 1998. Allowances in the future will be based on average housing costs in each geographic area. As the new program is phased in over a 6-year period, DOD officials stated that allowances in high-cost areas are expected to increase and allowances in low-cost areas are expected to remain constant or decline. However, largely because of limited coordination between the DOD offices responsible for housing allowances and housing management, service officials told us that they were uncertain how the new allowance program would affect the privatization initiative, but they did voice some concerns. For example, some officials questioned how a contractor under a privatization agreement would respond if rents were based on housing allowances and the allowances declined. Conversely, if allowances increased significantly, rental payments to the contractor could increase significantly, creating the potential for windfall profits.

Also, Marine Corps housing officials stated that if housing allowances increased, the need for on-base housing could decrease. For example, with larger allowances some occupants of privatized on-base housing might

move to community housing, leaving on-base vacancies available to civilians. This view appears to be supported by a 1997 study on military housing issues by the RAND organization. The study stated that the primary reason military families choose on-base housing is economics. Many families, particularly in lower paygrades, believe that the value of the on-base housing exceeds the amount of allowance they forfeit to live there. RAND also found that few families would choose to live in on-base housing if their housing allowances would permit them to obtain suitable housing in the community without considerable out-of-pocket costs.

Some Steps Have Been Taken to Improve Housing Plans

In November 1997, DOD took an important step in its planning by directing the services for the first time to submit plans for eliminating inadequate family housing. The services were directed to submit plans by May 1, 1998, that identify by installation, housing revitalization requirements and the potential for privatization. Although this information could be an important first step in developing comprehensive housing plans, DOD did not provide written guidance for the services to use in determining revitalization requirements and privatization potential. Further, comprehensive plans that integrate not only privatization but also other elements of DOD's housing program are needed. The DOD direction to the services did not require the plans to include steps to improve the requirements determination processes; maximize existing private sector housing; develop enhanced referral services; or coordinate use of allowances, military construction, and privatization options.

On its own initiative, the Air Force appears to have recognized the need for comprehensive, integrated housing plans. Air Force officials stated that privatization alone will not solve the housing problem and that the ultimate solution lies within an integrated approach. With this in mind, in August 1997, the Air Force began working with consultants to develop a housing master plan for each Air Force installation. Air Force officials stated that the master plans will define the most effective housing investment strategy by integrating construction, operations and maintenance revitalization, privatization, and reliance on local community housing. The Air Force expects the first portion of the plans, potential for privatization, to be completed by May 1998 to comply with the DOD direction. The overall master plans are expected to be completed in December 1998.

Conclusions

DOD needs to ensure that the services develop long-range, integrated housing plans that rely on and use all of the available tools; not in isolation, but in a coordinated, optimum manner. Such plans can provide the focus needed to ensure accurate housing requirements determinations, maximum use of suitable civilian housing, use of enhanced housing referral services, coordination of housing allowances changes, and appropriate use of privatization and Milcon alternatives.

DOD has taken some initial steps to developing better planning. However, additional steps can be taken to ensure that the military's housing problems are addressed in an optimum manner. Also, achieving a more integrated approach has been somewhat hampered by separate DOD organizations responsible for housing allowances and housing construction and management. Although there may be valid reasons for keeping these functions in separate offices, greater efforts are needed to ensure effective coordination on housing issues.

Recommendations

We recommend that the Secretary of Defense expand the directive to the services concerning their plans for eliminating inadequate housing. Specifically, the Secretary should direct the services to prepare detailed, integrated housing plans that will (1) describe their plans for improving their housing requirements determination processes, (2) demonstrate how they will attempt to maximize their reliance on community housing in accordance with DOD's stated policy, and (3) outline improvements in housing referral services. The plans should also include analyses of the estimated impact of the new housing allowance program on the availability of housing in local communities and show how housing allowances, traditional military construction, and the privatization initiative will be used in concert to meet DOD's housing needs in the most economical manner. Each service plan should include estimated milestones for achieving the goals of the plan.

We also recommend that the Secretary establish a mechanism to promote more effective coordination between the offices responsible for housing allowances and housing management.

Agency Comments and Our Evaluation

DOD partially concurred with our recommendations, stating that it is aware of the need to integrate effectively all the elements of its housing program. DOD said that the services already have begun making specific plans about whether privatization or military construction should be pursued at each

installation. DOD also stated that development of standard procedures for determining housing requirements is the subject of a working group first convened in December 1997, which includes representatives from each service. However, DOD stated that the legislative authority for privatization expires in 2001, unless extended or made permanent. As a result, DOD stated its immediate focus is on demonstrating at several prototype sites how housing privatization can be an effective tool for addressing DOD's housing problems. DOD stated that only after succeeding in this demonstration and in a demonstration of how other new elements of DOD's housing program can succeed will its focus turn toward the imperative of better integrating these new tools with all the other aspects of its housing program.

Although the steps DOD outlined are positive, we do not agree that DOD should wait until it can demonstrate successes in its privatization program before focusing on integrating the elements of its overall housing program. Better integration of housing elements is needed now to maximize the advantages of the initiative and ensure that housing is revitalized or constructed only at installations where the local communities cannot meet the military housing requirements. Also, we believe all the elements of our recommendation are important aspects of such integration. While DOD mentioned steps related to certain elements, it did not directly address those aimed at promoting maximum reliance on community housing. For example, DOD did not state whether it would encourage the services to improve their housing referral programs or analyze the impact of the new housing allowance program on available housing in the community before proceeding to revitalize or build new housing. We continue to believe that DOD should expand the directive to the services concerning development of installation housing plans to cover each element of our recommendation to help ensure maximum reliance on community housing. An expanded directive to the services in preparing their housing plans would help focus the services' attention on how they can use the full range of tools available to them in concert to address their housing problems in the most economical way. Moreover, requiring the services to set milestones for achieving their housing goals would help DOD measure progress in improving military housing.

DOD also agreed that coordination between the offices responsible for housing allowances and housing management is necessary and appropriate but stated existing coordination mechanisms are adequate and effective. We believe that improved coordination during development and implementation of the new allowance program could have increased

Chapter 3
Privatization Initiative Can Be Better
Integrated With Other Elements of DOD's
Housing Program

understanding of how the new program will affect the privatization initiatives. As noted in our report, service officials were uncertain about the relationship of the two initiatives. Moreover, as we pointed out, the new program could result in making more local community housing affordable to military families, thus reducing the need for privatized housing in some locations. We continue to believe that the relationship between military housing and allowances is extremely close, improved coordination between the offices responsible for these issues can lead to a more integrated approach to housing, and new mechanisms are needed to help achieve this improved coordination.

Summary of Authorities in the Military Housing Privatization Initiative

1. Direct loans: The Department of Defense (DOD) may make direct loans to persons in the private sector to provide funds for the acquisition or construction of housing units suitable for use as military family or unaccompanied housing. (10 U.S.C. 2873(a),(1))
2. Loan guarantees: DOD may guarantee a loan to any person in the private sector if the proceeds of the loan are used to acquire or construct housing units suitable for use as military family or unaccompanied housing. (10 U.S.C. 2873(b))
3. Build and lease: DOD may enter into contracts for the lease of military family or unaccompanied housing units to be constructed under the initiative. (10 U.S.C. 2874)
4. Investments in nongovernmental entities: DOD may make investments in nongovernmental entities carrying out projects for the acquisition or construction of housing units suitable for use as military family or unaccompanied housing. An investment under this section may include a limited partnership interest, a purchase of stock or other equity instruments, a purchase of bonds or other debt instruments, or any combination of such forms of investment. (10 U.S.C. 2875(a),(b))
5. Rental guarantees: DOD may enter into agreements with private persons that acquire or construct military family or unaccompanied housing units under the initiative to guarantee specified occupancy levels or to guarantee specific rental income levels. (10 U.S.C. 2876)
6. Differential lease payments: Pursuant to an agreement to lease military family or unaccompanied housing to servicemembers, DOD may pay the lessor an amount in addition to the rental payments made by military occupants to encourage the lessor to make the housing available to military members. (10 U.S.C. 2877)
7. Conveyance or lease of existing property and facilities: DOD may convey or lease property or facilities, including ancillary supporting facilities, to private persons for purposes of using the proceeds to carry out activities under the initiative. (10 U.S.C. 2878)
8. Interim leases: Pending completion of a project under the initiative, DOD may provide for the interim lease of completed units. The term of the lease may not extend beyond the project's completion date. (10 U.S.C. 2879)

Appendix I
Summary of Authorities in the Military
Housing Privatization Initiative

9. Conformity with similar local housing units: DOD will ensure that the room patterns and floor areas of military family and unaccompanied housing units acquired or constructed under the initiative are generally comparable to the room patterns and floor areas of similar housing units in the locality concerned. Space limitations by paygrade on military family housing units provided in other legislation will not apply to housing acquired under the initiative. (10 U.S.C. 2880(a),(b))
10. Ancillary supporting facilities: Any project for the acquisition or construction of military family or unaccompanied housing units under the initiative may include the acquisition or construction of ancillary supporting facilities for the housing. (10 U.S.C. 2881)
11. Assignment of members of the armed forces to housing units: DOD may assign servicemembers to housing units acquired or constructed under the initiative. (10 U.S.C. 2882)
12. Lease payments through pay allotments: DOD may require servicemembers who lease housing acquired or constructed under the initiative to make lease payments by allotment from their pay. (10 U.S.C. 2882(c))

Privatization Projects Under Consideration as of January 1998

Dollars in millions

Service	Project	Number of units			Site: located on base or off base	Estimated fiscal year for contract award	Estimated construction costs	
		Replaced	Renovated	Additional new housing			Total	Government contribution ^a
Army	Fort Carson	0	1,824	840	2,664	On	1998	\$220.0
	Fort Hood	700	4,240	1,043	5,983	On	2000	\$315.0
	Fort Stewart	141	2,785	133	3,059	On	2000	\$179.0
	Fort Lewis	730	2,619	366	3,715	On	2000	\$305.0
Air Force	Dyess	0	0	402	402	Off	1999	\$25.8
	Elmendorf	0	320	300	620	On	1999	\$79.3
	Kirtland	1,066	759	0	1,825	On	1999	\$26.4
	Lackland	272	0	148	420	On	1998	b
	Mt. Home	0	497	0	497	On	1999	\$21.2
	Peterson A	0	0	200	200	Off	1999	b
	Peterson B	0	0	182	182	On	1999	\$57.0
	Robins	0	300	370	670	On	1999	\$44.9
Navy	Everett II	0	0	400	400	Off	1999	b
Marine Corps	Pendleton	0	512	204	716	On	1998	\$20.0
	Albany	160	0	0	160	On	1998	b
Total		3,069	13,856	4,588	21,513			

Note: This table does not include many potential privatization projects that are in the early planning stages. For example, the Navy has begun planning a potential regional privatization project in San Diego, California, and the Marine Corps has begun planning for projects at Beaufort, South Carolina, and Camp Lejeune, North Carolina.

^aThe government contribution column does not include the value of any government assets conveyed.

^bAn estimate was not available at the time of our review in January 1998.

Source: Data provided to us in January 1998 by service officials.

Navy's Limited Partnership Agreements for Housing at Corpus Christi, Texas, and Everett, Washington

The Congress approved legislation in October 1994 that gave the Navy authority to test the use of limited partnerships with the private sector to develop family housing for Navy servicemembers and their families. The Navy initiated two limited partnership agreements using this earlier authority to help meet family housing shortages for enlisted servicemembers in the Corpus Christi, Texas, and the Everett, Washington, areas.

Housing at Corpus Christi, Texas

At Corpus Christi, the Navy entered into a limited partnership agreement in July 1996 with a private developer to build and operate 404 family housing units at two locations. The units, all completed and ready for occupancy by November 1997, were built off base using commercial building standards and practices. The Navy contributed \$9.5 million to the project, and the developer financed the balance of the project's \$32 million total cost. In return for its contribution, occupancy preferences were given to Navy families, and rents were targeted to be affordable on the basis of enlisted paygrade E-5 housing allowances. When a vacancy occurs, the developer gives the Navy 45 days to find a military tenant. If a Navy family does not rent the vacant unit, the developer can offer the unit to civilians. Each tenant, military or civilian, is responsible for paying utilities.

The limited partnership agreement lasts 10 years, with a 5-year option period. At the end of the partnership, the units will be sold. The agreement calls for the developer to repay the Navy its initial equity contribution, plus one-third of the net sale proceeds.

The units include two-bedroom, three-bedroom, and four-bedroom townhouse units. Each unit includes a range, a refrigerator, a dishwasher, a microwave oven, washer and dryer connections, and a carport. The two-bedroom unit has about 1,030 gross square feet and two baths, the three-bedroom unit has about 1,207 gross square feet and two baths, and the four-bedroom unit has about 1,355 gross square feet and two baths.

The 404 units were constructed at two locations—Portland and Kingsville—to serve separate Navy installations in the area. To serve the Corpus Christi Naval Air Station and the Ingleside Naval Station, 302 units were constructed near Portland, a community about 22 miles from the Naval Air Station and about 16 miles from the Naval Station. The partnership agreement established the initial rental rates for the units and stated that the rates could be adjusted annually on the basis of the percentage change in a specified housing cost index. The 1997 monthly

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Navy's Limited Partnership Agreements for
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Everett, Washington

rents at Portland for two-bedroom, three-bedroom, and four-bedroom units were \$598, \$660, and \$798, respectively. Local Navy housing officials estimated that monthly utilities averaged \$136. Thus, total estimated monthly costs were \$734, \$796, and \$934 for two-bedroom, three-bedroom, and four-bedroom units, respectively.

The 1997 monthly housing allowance for a paygrade E-5 member at Corpus Christi was \$588. Thus, a paygrade E-5 servicemember that rented a two-bedroom unit at Portland paid \$146, or about 25 percent, more than the member's housing allowance. In comparison, a paygrade E-4 member renting a two-bedroom unit paid \$207, or about 39 percent, more than the allowance for an E-4 member, and a paygrade E-6 member paid \$93, or about 15 percent, more than the allowance for an E-6 member. On average, throughout the United States, military members living in civilian housing pay about 20 percent more for their housing than their allowances. Table III.1 provides more details on out-of-pocket costs at Portland.

Table III.1: Out-of-pocket Costs at Portland in 1997

Unit type	Rent plus estimated utilities	Out-of-pocket costs*					
		Paygrade E-4		Paygrade E-5		Paygrade E-6	
		Amount	Percent	Amount	Percent	Amount	Percent
2 bedroom	\$734	\$207	39	\$146	25	\$93	15
3 bedroom	\$796	\$269	51	\$208	35	\$155	24
4 bedroom	\$934	\$407	77	\$346	59	\$293	46

*Out-of-pocket costs represent the difference between rent plus estimated utilities and the member's housing allowance.

Source: Service housing officials at Corpus Christi Naval Air Station.

At the time of our visit in January 1998, not all of the units were occupied. Of the 302 units, 178 units were occupied by the military, 61 units were occupied by civilians, and 63 units were vacant. (See table III.2.)

Table III.2: Occupancy at Portland in January 1998

Occupant category	Number of units	Percent
Enlisted E-5 and below	82	27
Enlisted E-6 and above	78	26
Officer	18	6
Civilian	61	20
Vacant	63	21
Total	302	100

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Representatives from the Navy and the developer stated that the vacancies existed because (1) many units were completed during the fall after the time when most members transfer to the area and (2) the units had not been aggressively marketed to civilians. The developer's representative stated that plans existed to increase marketing to civilians. Navy representatives also stated that there were 493 servicemembers on the waiting list for family housing at Corpus Christi. However, because these families had not chosen to rent at the Portland project, they apparently preferred waiting for on-base family housing at Corpus Christi, which would result in no out-of-pocket costs and a shorter commute to work.

To serve the Kingsville Naval Air Station, 102 two- and three-bedroom units were constructed on private property in Kingsville, a community located about 40 miles from Corpus Christi. The 1997 monthly rent at Kingsville was \$498 for a two-bedroom unit and \$598 for a three-bedroom unit. Local Navy housing officials estimated that monthly utilities averaged \$121. Thus, total estimated monthly costs were \$619 and \$719 for two-bedroom and three-bedroom units, respectively.

The 1997 monthly housing allowance for a paygrade E-5 servicemember at Kingsville was \$553. Thus, a paygrade E-5 servicemember that rented a two-bedroom unit at Kingsville paid \$66, or about 12 percent, more than the member's housing allowance. In comparison, a paygrade E-4 member renting a two-bedroom unit paid \$154, or about 33 percent, more than the allowance for an E-4 member; and a paygrade E-6 member paid \$17, or about 3 percent, more than the allowance for an E-6 member. Table III.3 provides more details on out-of-pocket costs at Kingsville.

Table III.3: Out-of-pocket Costs at Kingsville in 1997

Unit type	Rent plus estimated utilities	Out-of-pocket costs ^a					
		Paygrade E-4		Paygrade E-5		Paygrade E-6	
		Amount	Percent	Amount	Percent	Amount	Percent
2 bedroom	\$619	\$154	33	\$66	12	\$17	3
3 bedroom	\$719	\$254	54	\$166	30	\$117	19

^aOut-of-pocket costs represent the difference between rent plus estimated utilities and the member's housing allowance.

Source: Service housing officials at Kingsville Naval Air Station.

At the time of our visit to the Kingsville units in January 1998, all of the units were occupied. Of the 102 units, 90 units were occupied by the

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military, and 12 units were occupied by civilians. However, the majority of the units, 68 units, were occupied by military officers rather than enlisted personnel. (See table III.4.)

Table III.4: Occupancy at Kingsville in January 1998

Category of occupant	Number of units	Percent
Enlisted E-5 and below	15	14
Enlisted E-6 and above	7	7
Officer	68	67
Civilian	12	12
Vacant	0	0
Total	102	100

Although all of the units at Kingsville were occupied, Navy officials stated that the project was not serving junior enlisted members to the extent envisioned when the project was developed. Most of the units were occupied by single, junior-level officers, many of whom shared the units with another single, junior-level officer. The partnership agreement did not provide for specific rental preferences for enlisted servicemembers with families, and local housing officials did not attempt to secure vacancies for enlisted members.

Housing at Everett, Washington

In March 1997, the Navy entered into a 10-year limited partnership with a private developer to build and operate 185 family housing units in the Everett, Washington, area. The housing was intended primarily to serve servicemembers assigned to the Everett Naval Station, located about 18 miles away. The Navy contributed \$5.9 million to the project, and the developer financed the balance of the project's \$19 million total cost.

Beginning in the 6th year, 20 percent of the units will be sold annually. Navy families occupying the units will be given an opportunity to purchase the units. The Navy will share in the net proceeds from the sales, and by the end of the agreement, the Navy will have been repaid its initial equity contribution plus one-third of any additional net sale proceeds. In return for its contribution, occupancy preferences were given to Navy families, and rents were targeted to be affordable on the basis of enlisted paygrade E-5 housing allowances. When a vacancy occurs, the developer gives the Navy 30 days to find a military tenant. If a Navy family does not rent the vacant unit, the developer can offer the unit to civilians. Each tenant, military or civilian, is responsible for paying utilities.

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The Everett units were constructed off base using commercial building standards and local practices. Each townhouse unit includes a range, a refrigerator, a dishwasher, a washer, a dryer, and a two-car garage. Excluding the garage, the two-bedroom unit has about 1,160 gross square feet and two baths, the three-bedroom unit has about 1,212 gross square feet and two and a half baths, and the four-bedroom unit has about 1,556 gross square feet and two and a half baths.

The partnership agreement established the initial rental rates for the units and stated that the rates would be adjusted annually on the basis of the percentage change in a specified housing cost index. The 1997 monthly rents for two-bedroom, three-bedroom, and four-bedroom units were \$725, \$750, and \$850, respectively. Local Navy housing officials estimated that average monthly utilities for two-bedroom, three-bedroom, and four-bedroom units were \$130, \$140, and \$155, respectively. Thus, total estimated monthly costs were \$855, \$890, and \$1,005 for two-bedroom, three-bedroom, and four-bedroom units, respectively. The 1997 monthly housing allowance for a paygrade E-5 servicemember at Everett was \$712. Thus, a paygrade E-5 servicemember that rents a two-bedroom unit paid \$143, or about 20 percent, more than the member's housing allowance. In comparison, a paygrade E-4 servicemember renting a two-bedroom unit paid \$269, or about 46 percent, more than the allowance for an E-4 servicemember; and a paygrade E-6 servicemember paid \$38, or about 5 percent, more than the allowance for an E-6 member. Table III.5 provides more details about out-of-pocket costs at Everett.

Table III.5: Out-of-pocket Costs at Everett in 1997

Unit type	Rent plus estimated utilities	Out-of-pocket costs ^a					
		Paygrade E-4		Paygrade E-5		Paygrade E-6	
		Amount	Percent	Amount	Percent	Amount	Percent
2 bedroom	\$855	\$269	46	\$143	20	\$38	5
3 bedroom	\$890	\$304	52	\$178	25	\$73	9
4 bedroom	\$1,005	\$419	71	\$293	41	\$188	23

^aOut-of-pocket costs represent the difference between rent plus estimated utilities and the member's housing allowance.

Source: Service housing officials at Everett Naval Station.

At the time of our visit to Everett in January 1998, all of the units were occupied. Of the 185 units, 184 units were occupied by the military, and

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1 unit was occupied by a civilian, the on-site project manager. (See table III.6.)

Table III.6: Occupancy at Everett in January 1998

Category of occupant	Number of units	Percent
Enlisted paygrade E-5 and below	112	60
Enlisted paygrade E-6 and above	72	39
Officer	0	0
Civilian	1	1
Vacant	0	0
Total	185	100

Local Navy housing officials stated that management attention helps ensure that junior enlisted servicemembers receive preference in renting units at the Everett project. The local housing office maintains separate waiting lists for paygrades E-6 and below and paygrades E-7 and above. When notified of a vacancy, the housing office takes a proactive role in getting an enlisted servicemember to fill the vacancy.

DOD's and Our Assumptions Used in Life-Cycle Cost Analysis for Fort Carson

Alternative and cost factor	DOD estimate	Our estimate	Comments on differences in cost factors
Military Construction:^a			
Construction costs for new units (per unit)	\$123,550	Same	
Revitalization costs for existing units (per unit)	\$65,729	Same	
Operations and maintenance costs (annual per unit)	\$8,102	\$6,385	Our estimate was based on Army's fiscal year 1999 budget request, including utilities.
Revitalization costs for all units in year 25 of operation (per unit)	\$65,729	Same	
Education impact fee (annual per unit)	\$1,995	Same	
Privatization alternative:			
Government contribution	\$36,577,000	Same	
Housing allowances (annual average per unit)	\$8,528	\$8,040	Our estimate was based on 1998 allowances for paygrades of proposed occupants.
Utilities costs (annual average per unit)	\$0	\$1,414	Army pays utilities. Our estimate was based on Army's fiscal year 1999 budget request for utilities.
Housing management costs (annual average per unit)	\$113	Same	
Education impact fee (annual per unit)	\$1,995	Same	
Both alternatives:			
Discount rate	3.6%	3.8%	Our estimate was based on the 1998 Office of Management and Budget (OMB) discount rate.
Total years in analysis	50	Same	

^aMilcon.

DOD's and Our Assumptions Used in Life-Cycle Cost Analysis for Lackland Air Force Base

Alternative and cost factor	DOD estimate	Our estimate	Comments on differences in cost factors
Milcon alternative:			
Construction costs for new units (per unit)	\$131,575	Same	
Operations and maintenance costs (annual per unit)	\$6,325	Same	
Revitalization costs for year 25 of operation (annual set-aside per unit)	\$2,887	\$0	We assumed Milcon funds appropriated for revitalization in year 25 of operation.
Revitalization costs for all units in year 25 of operation	\$0	\$65,729	We assumed Milcon funds appropriated for revitalization in year 25 of operation. We used same amount per unit as the Army used in the Fort Carson analysis.
Education impact fee (annual per unit)	\$0	\$2,000	We included an estimate for education impact fees.
Privatization alternative:			
Government contribution	\$18,301,000	Same	
Housing allowances (annual average per unit)	\$6,361	\$7,307	Our estimate was based on 1998 allowances for paygrades of proposed occupants.
Utilities costs (annual average per unit)	\$2,316	Same	
Housing management costs (annual average per unit)	\$0	\$150	We estimated this cost based on one-third of current budgeted amount for housing management costs.
Education impact fee (annual per unit)	\$0	\$2,000	We included an estimate for education impact fees.
Both alternatives:			
Discount rate	3.0%	3.8%	Our estimate was based on the 1998 OMB discount rate.
Total years in analysis	40	50	We used the expected term of the agreement.

Comments From the Department of Defense



OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000



June 26, 1998

Mr. Mark E. Gebicke
Director, Military Operations and Capabilities Issues
National Security and International Affairs Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Gebicke:

I appreciate this opportunity to respond to your draft report, "MILITARY HOUSING: Privatization Off to a Slow Start and Continued Management Attention Needed." dated May 19, 1998 (GAO Code 703244, OSD Case 1621). The Department of Defense partially concurs with the report.

The GAO report points out that privatization has proceeded more slowly than initially expected because the initiative represents a new way of doing business for both the military and the private sector. We believe the time we have taken was appropriate and necessary to resolving critical program issues that will assure timely and effective implementation of all subsequent projects. Proceeding more rapidly would have created major long-term problems for the program. As noted in the report, the Housing Revitalization Support Office had to develop protocols for site visits as well as new tools and models to assess the financial feasibility of the various authorities provided by the legislation. New and complex legal issues had to be addressed and resolved. Not least, financial, contractual, and budgetary scoring issues had to be resolved to the satisfaction of the government, developers, and private lenders.

The report contains two recommendations with which we partially concur, and several findings of fact with which we take issue. Our detailed responses to each recommendation are enclosed, however, I want also to highlight a few observations. *First*, the GAO's life cycle cost estimates for the projects at Fort Carson and Lackland Air Force Base indicate life cycle savings of between 7 percent and 10 percent when compared to comparable costs paid through family housing MILCON. Although less than DOD's projections, even these savings are nonetheless significant. In addition, it is important to recognize that the type of economic analysis by which the GAO made its estimates assumes the availability of adequate appropriated funding for MILCON projects that would be comparable to the privatized housing projects. In fact, family housing MILCON is not available at these levels, and simple comparisons between alternatives tend to obscure this important underlying reality. The Department's inability quickly to resolve the shortcomings of its housing programs in the light of funding constraints was a major factor in its decision to privatize family housing as a means of maintaining quality of life for our military members. We also expect commercial management of housing to result in better maintenance



Appendix VI
Comments From the Department of Defense

than under government ownership, and have put explicit controls into privatization contracts, including mandatory reserve accounts, to ensure that this will be the case.

Second, the Department is aware of the need to integrate effectively all the elements of DOD's housing program, and we are working on effecting this integration. The Department's components already have begun making specific plans about whether privatization or military construction should be pursued at each installation. We also are standardizing our methodology for analyzing life cycle costs, which will incorporate for application to all future projects the important lessons learned from Fort Carson and Lackland Air Force Base.

Providing safe, adequate housing for service members is a Departmental priority. I appreciate GAO's review of our privatization process and resulting recommendations. I assure you that we are working hard to make the housing privatization program a success.

Sincerely,



John B. Goodman
Deputy Under Secretary
(Industrial Affairs and Installations)

Enclosure

**GAO DRAFT REPORT - DATED MAY 19, 1998
(GAO CODE 703244) OSD CASE 1621**

**“MILITARY HOUSING: PRIVATIZATION OFF TO A SLOW START AND
CONTINUED MANAGEMENT ATTENTION NEEDED”**

DEPARTMENT OF DEFENSE COMMENTS TO THE RECOMMENDATIONS

RECOMMENDATION 1: To ensure that the privatization initiative is effectively integrated with other elements of DoD's housing program, the GAO recommended that the Secretary of Defense expand the directive to the Services concerning their plans for eliminating inadequate housing. Specifically, the Secretary should direct the Services to prepare detailed, integrated housing plans that will (1) describe service plans for addressing long-standing weaknesses in their housing requirements determination processes; (2) demonstrate how the Services will attempt to maximize its reliance on community housing in accordance with DoD's stated policy; (3) outline improvements in housing referral services; (4) include analysis of the estimated impact of the new housing allowance program on the availability of housing in local communities; and (5) show how housing allowances, traditional military construction, and the privatization initiative will be used in concert to meet DoD's housing needs in the most economical manner. Each service plan should include estimated milestones for achieving the goals of the plan. (p. 10, p. 44/GAO Draft Report)

DOD RESPONSE: Partially concur. We agree that the privatization initiative needs to be effectively integrated with other elements of DoD's housing program, and we already are working to effect that integration. For example, development of a standard procedures for determining housing requirements is the subject of a working group first convened in December 1997 which includes representatives from each Military Service. The new Basic Allowance for Housing (which replaces the Basic Allowance for Quarters and Variable Housing Allowance systems) also is already being implemented. The Department has undertaken a review of each Military Service's base-by-base master plans for family housing in order more accurately to quantify the resource requirements for revitalizing housing that will be necessary in consideration of both privatization and military construction initiatives. Finally, the report should take note that the housing privatization initiative is proceeding under legislative authority which expires in 2001, unless extended or made permanent. As a result, our immediate focus is on demonstrating at several prototype sites how housing privatization can be an effective tool for addressing DoD's housing problems. Only after having succeeded in this demonstration and in a demonstration of how other new elements of DoD's housing program can succeed will our focus turn toward the imperative of better integrating these new tools with all the other aspects of DOD's housing program.

Now on pp. 9 and 38.

Now on pp. 9, 30, and 38.

RECOMMENDATION 2: The GAO recommended that the Secretary of Defense (1) establish a mechanism to promote more effective coordination between the offices responsible for housing allowances and housing management and (2) expedite DoD's effort, including establishing and monitoring milestones, to develop a standardized methodology for comparing life-cycle costs proposed privatization projects with military construction alternatives. (pp. 10-11, p. 35, p. 45/GAO Draft Report)

DOD RESPONSE: Partially concur. The life cycle cost analyses provided for the initial housing privatization projects utilized the distinct methodologies then employed by each Military Department. The results of these individual methods correctly demonstrate privatization as a cost effective alternative to MILCON. However, we agree that a consistent presentation of life cycle cost comparisons is desirable and necessary. As a result, we already are developing a standard methodology for application to all future projects that incorporates lessons learned from the analyses of the Fort Carson and Lackland Air Force Base projects. Finally, while we agree that coordination between the offices responsible for housing allowances and housing management is necessary and appropriate, we also believe that the existing mechanisms are adequate and effective.

Major Contributors to This Report

National Security and International Affairs Division, Washington, D.C.

Carol Schuster, Associate Director
William Solis, Assistant Director
Charles Perdue, Senior Economist

Norfolk Field Office

Gary Phillips, Evaluator-in-Charge
James Ellis, Senior Evaluator